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S&P Yield:1.41%; S&P p/e: 44.6; Gold 50 day MA:297

REAL MONEY : Older subscribers know that when I use the phrase "real money" I'm talking about gold. And unknown to the vast majority, real money is starting to overpower the entire universe of US investments. After all, almost everything you own is denominated in dollars. But if gold is moving up against dollars, then gold is moving up against the majority of almost everything you own.

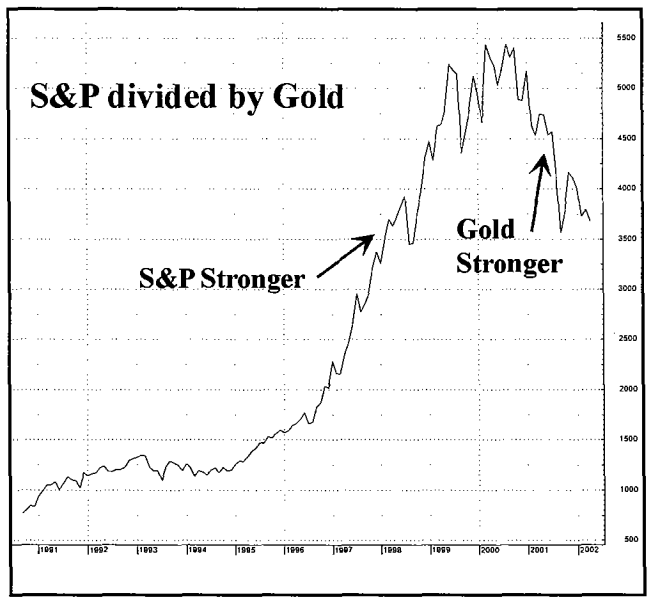
The central banks (including our own beloved Fed) see gold or real money as a danger to their power. And I'm talking about the central banks' power to control their fiat money, money that the Fed creates "out of thin air." Therefore, the central banks have done everything in their power to disparage gold – even to the point of announcing widely their periodic sales of the yellow metal.

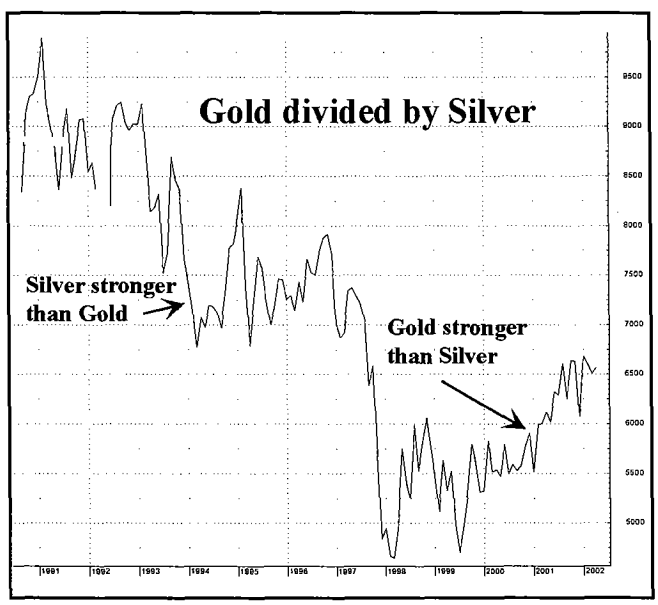
Despite the activities of the Fed and its allies, gold has been creeping higher. From a low of 256 in August of 1999, gold has now pushed over 300 dollars an ounce.

But gold, I believe, is still in a basing pattern, and basing patterns move slowly and take a long time to complete. At any rate, I am including two interesting charts of the "precious metals," better known as gold and silver.

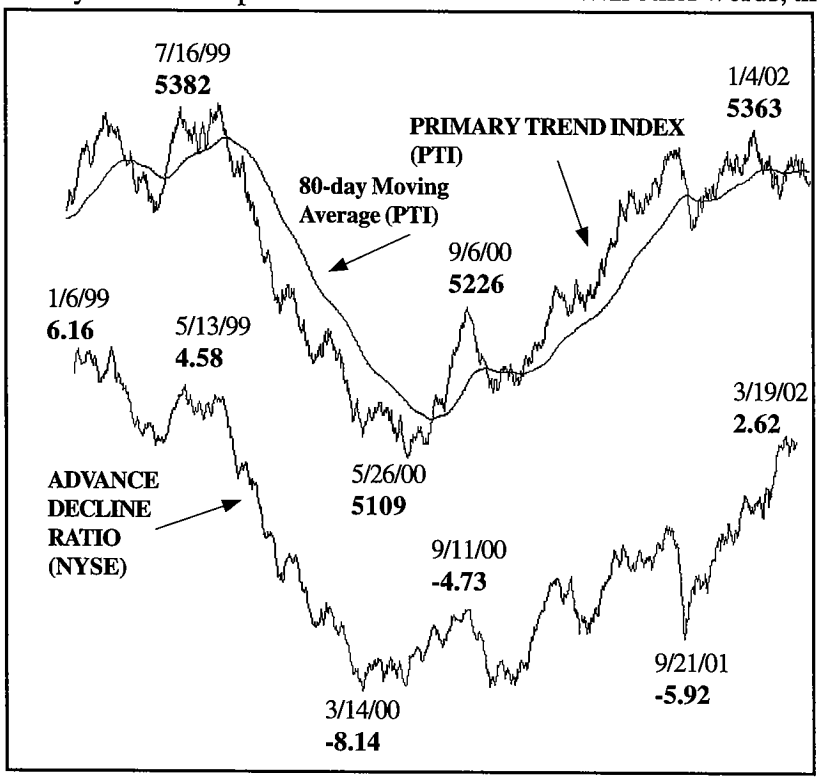
The first chart is a monthly ratio chart showing the S&P 500 Stock Index divided by gold. Here we see that the ratio hit a high in March 2000, at which time the S&P would buy 5.4 ounces of gold. From there the ratio declined to the point where today the S&P will buy 3.7 ounces of gold. But the trend is clear and the formation is bullish for gold. It would not shock me to see a time when the S&P will only buy one ounce of gold.

The second chart shows gold divided by silver. Silver outperformed gold for years up to March of 1998. At that time an ounce of gold would buy 46 ounces of silver. But since March of 1998 gold has tended to outperform silver. Today, an ounce of gold will buy 65 ounces of silver.





Why is this? It could be that only gold is considered real money whereas silver is still considered by many an industrial metal. In the fragile markets of today, investors, or at least many of them, want ultimate security; they want real money, money that is not a product of some central bank. In other words, they want gold.



THE PICTURE: Investors who buy stocks here have to deal with two major problems. The first problem is current valuations, which are extremely high. The second problem is dividends, which are extremely low.

We know that when price-earnings ratios for the S&P are above 20, the median annual return over the coming ten years is about 5%. But these statistics were computed in an era when average dividend yield was running at around 4.5%

We also know that over any extended period of time, dividends have accounted for a major portion of the total return on stocks. According to *Growth Stock Outlook* of Chevy Chase, Maryland, from 1871 to 1997 the total market return for stocks was around 7% — 5.4% from dividends and 1.6% from stock appreciation. So question – what can we expect over say a ten-year period starting from a base of over 40 times trailing earnings for the S&P and a dividend yield of 1.3%? The point is that it makes a huge difference as to what base we start from. Today, we start with one of the most overvalued bases in history, and from a base in which there are almost no dividends.

Warren Buffett, the so-called "Sage of Omaha," suggests that we'd be lucky to see a total annual return from stocks over the next ten years of as much as 7%. I think Buffett is being optimistic. Considering the base from which we're starting, my own thought is that today's investors would be lucky to break even in ten years with stocks bought today. In other words, stocks today are not priced to generate long-term total return profits.

I use *Investor's Business Daily's* Mutual Fund Index (23 leading growth equity funds) as my picture of how the typical American is doing in the stock market. Right now the Mutual Fund Index is down 5.3% for the year. Thus, for the typical American stockholder and consumer, this would mark the third year in a row that he or she has been losing money in the stock market.

Two years of losses is hard to take. Three successive years of losses is "too much" to take. I believe that the US consumer is now starting to cut back on his spending. If this happens, all forecasts of "the end of the recession" will be called into question. As those who have tuned in to my daily site know, the Transports following their March 4 peak have given us ample warning that something is wrong. The March peaks in both the D-J Industrials and the D-J Transports have not been bettered.

Unfortunately, we are now in the "no profit" part of the year. This is the six months starting in May and ending in October when, historically, you would have been better off being out of the market.

I have been talking about the movement of "big money," the sophisticated money that sets the trends of the market at bull market tops and at bear market bottoms. I watch three areas to provide me with hints as to what the big money is doing.

The first area is insider trading. Recently, insiders have been selling at a ratio of four shares sold for every one bought. The second I watch is the direction of the 15 most active stocks on the NYSE. I run an index of the daily plurality of the 15 most active. On September 21, at the market low, my index stood at 612. The index is now well below its level of September 21. This tells me that big money has been saying "bye" to this market.

I run another index. Each day I check the 10 largest-cap stocks in the S&P. I tabulate the plurality and run a simple advance-decline index of these pluralities. The high for this index was struck at 890 on March 15. The low this year was recorded on Feb.19 at 841. This index is now at 847.

Question: Russell, you say the big money, the smart money, is leaving this market. If so, what are they going to do with their money?

Answer: Check the article on the front of my site, the article entitled "Rich Man, Poor Man." Consider the following: We have two people. One has assets of $300,000. The other has assets of $10 million.

The one with $300,000 wants to be safe. But if he puts his money in a money market fund he receives say $3 to $5 thousand a year. He can't live on that. So he puts some of his money in the stock market, hoping to pick up some capital gains. But instead, he sustains a loss in the stock market.

The fellow with the $10 million — he doesn't need the stock market. The millionaire puts most of his money in five-year AAA-rated municipal bonds, and he collects $350,000 tax-free. He's happy, he's collecting all the money he needs. As for the stock market, "forget it," he says, "prices are too high and there's no return. I'll just wait for the real values, whenever that is. Hey, I'm in no hurry."

Rich man, poor man, the never-ending story.

There's another phenomenon taking place. It's what I term a generational change. I'll be frank – I don't think the average investor is going to make money in the stock market over the next five years and maybe over the next ten years. I don't think the average investor will make money over the foreseeable future and I don't think the average investor is making money now.

Why? Because if you hold stocks here or if you're buying stocks here you're starting from too high a valuation base. It all depends on where you start. Start in an undervalued area and you'll probably do fine. Start from an overvalued area, and believe me, the market is currently super-overvalued, and you'll be very lucky to break even in the coming five or even ten years.

Aside from overvaluation, there is another problem that today's investors must face. And it's that generational change that I mentioned above.

The system of debts and credits that the Federal reserve has established is starting to tremble. There's just too much debt in the system. Over the last year the Fed has flooded the system with over a trillion dollars in credit. The Fed has also dropped interest rates to the greatest extent in a short period of time, in history.

If the Fed had done that 15 years ago you'd be experiencing the damnedest explosion in inflation that you can imagine. Then how is it that we're not being battered by inflation now?

The reason is that the forces of debt, the contractionary forces, are so powerful that even a trillion dollars injected into the system can't generate galloping inflation. On top of that, we're experiencing the toughest global competition in our history. The fact is that the world is now producing too much. It's producing more than consumers can consume.

What about the huge change I've been talking about? The change is the slow, subtle switch out of financial assets and into tangible assets.

Tangible assets? That's right, and the number one tangible asset in the nation right now is a home. Home prices are appreciating like mad – some analysts are even talking about the "housing bubble." You see a house is not something that can be imported like a TV set, an SUV or a washing machine.

Consciously or unconsciously, investors have started to distrust the debt and credit system that the Fed has thrust upon us. People see the surging money supply, the debt, the bankruptcies, the declining corporate earnings, the lay-offs, and the factories moving overseas. And they see the US negative balance-of-payments, they decide that they want to be outside the system that the Fed has created. That means being in tangibles – homes, land, real estate, gold, silver, base metals, something of intrinsic value – in short, something that is not going to go bankrupt when the "big unraveling" arrives.

Make no mistake about it, the central banks of the world are doing everything in their power to keep that power intact, to keep their systems of bank credit and debt afloat. Slowly but surely, however, the central banks are losing the war. The most visible enemy of the central banks is gold. Gold is real money, intrinsic money, and despite years of adverse propaganda, people intuitively know that gold is something of value. Look in any jewelry store window and you'll see the gold – gold bracelets, gold watches, gold rings and gold trinkets. Gold is pure value. And it's outside the central banks' system. Gold is the enemy of paper money. The central banks hate gold – and they fear gold. And they will do whatever they have to – to keep the price of gold down in terms of their paper money.

But just as the truth of anything ultimately surfaces, the truth of real money is now beginning to surface. It's going to be a fascinating battle – gold against paper. My suggestion – take some kind of a position in gold, gold coins, gold stocks, gold, gold, gold. The percentage of your assets is a personal choice.

NOTES & QUOTES: Water, Water – but not everywhere. Here are a few facts about water. Human consumption of water doubles every 20 years at current rates, which far exceeds the increase in population. The richest nations waste far more water than the poorest nations. For instance, each person in North America consumes on average 1,280 cubic meters (about 45,000 cubic feet) of water each year. Europeans use 694 cubic meters; Asians use 535, South Americans 311 and Africans 186. Americans, even near the desert, expect to turn on the tap and get clean, drinkable water, plus water for their lawns, swimming pools and even for their pets. But human beings consume only 10 percent of the fresh water used annually. Industry is incredibly water intensive. It takes 105,000 gallons of water to make one car. Even the "clean" computer industry uses 390 gallons of water and produces 79 billion gallons of waste water annually, turning Silicon Valley into the home of more highly toxic EPA Superfund sites than any other region of the country.

And while other industry accounts for 20% to 25% of fresh water use, agriculture uses 65% to 70% percent of all water used by human beings. On top of everything else, massive pollution of the world's surface water has placed a great strain on the remaining supplies of clean fresh water. It is a fact that while we can live without air conditioning, lights and other devices powered by energy, we can not live without water.

Along these lines, I've been advocating water stocks for years. My favorite has been the largest US water company, American Water Works. AWK has been taken over by a foreign outfit, but that does not mean it isn't an interesting stock. At any rate, the following water companies have listed stocks, and you might want to check these stocks out on www.bigcharts.com and perhaps buy a package of all five of them. Here they are – AWK, CWT, WWTR, CWDO, SWWC.

I do know one thing – water or the lack of clean fresh water is going to be a crucial problem as the years go by. The world's population is increasing – so is the world's pollution. And as civilization progresses, each individual's desire for water increases. They talk about growth industries; water is a growth NEED.

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A very knowledgeable subscriber sent me a page from the authoritative *Automotive News*. He writes, "If class 8 (heavy) trucks aren't selling, then you know that transportation in the US is slowing down. Further proof of why Transports are weak. I checked the figures and sure enough for class 8 trucks in the first two months of 2001, 55,761 heavy trucks were sold. For the first two months of 2002, 43,101 heavy trucks were sold.

The article starts, "Class 8 sales tumble 20% in February. The almost two-year slide in class 8 trucks continues. Peterbilt has the steepest percentage decline, down 32% percent to 1,008 units. Mack had the second sharpest drop, down 19.3% to 1,156 units sold."

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The US housing market may be local, but housing finance is most definitely global. Data from the Federal Reserve shows that in recent years foreign investors have poured hundred of billions of dollars into the US annually, with Japan and Britain in the lead. All together, this foreign money finances a fat 20% of all the business and residential investments in the US.

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Foreign money doesn't go directly into the housing market, but this money does gobble up huge quantities of mortgage backed securities issued by mortgage underwriters Fannie Mae and Freddie Mac. In the fourth quarter, for instance, foreigners bought a whopping 32% of the so-called agency securities issued by Fannie and Freddie and other government sponsored enterprises. Without this huge flow from foreigners, US interest rates would be much higher.

One of the plusses in buying US Securities has been the strong dollar. Along these lines, I have been urging my daily site-readers to keep their eyes glued to the June Dollar Index. The critical near-term support for the June Dollar Index is at 117.00. As this is written, the index is at 117.59.

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In an ominous piece in the op-ed section of the *NY Times*, columnist Thomas Freidman writes about the Palestinian suicide bombers. He notes that just as the Spanish Civil war was a testing ground for the Allies and the Germans tested their weapons prior to World War II, the Israeli-Palestinian conflict is a testing ground to see whether "suicide terrorism can succeed as a strategy for liberation." And I'm wondering whether suicide terrorism is going to be the next "weapon" to be used broadly by terrorists around the world.

INVESTMENT POSITION—Slowly but surely it is becoming accepted that at current valuations, stocks will be hard-pressed over the next ten years to provide average total returns of more than 5% to 7% a year. Actually, I believe that's an optimistic reading of the situation.

I say this is an "optimistic" interpretation, because as I see it we're in the early stages of a primary bear market, following the bursting of one of the biggest bubbles in financial history. Therefore, I believe the market could act even worse than it would ordinarily be expected to, following a "more normal" bull market top. To put it simply, the bigger the bull market the bigger the bear market that follows.

Also, one phenomenon that has bothered me (and I've talked about this endlessly) is the extraordinary and persistent bullishness that has literally taken over the psyches of US investors. It's as if nothing will turn them pessimistic regarding equities. History suggests that one extreme, in time, goes to the opposite extreme. Therefore, as or when this bear market ends, I expect to see severe and chronic pessimism prevail. At that time, I suspect we're going to see illiquidity as carloads of small-cap and mid-cap stocks will be thrown on the market for whatever price they will bring.

This presents us with the problem – where do we put our money? My own inclination is to place the bulk of my money into the safest municipal bonds that I can find. These bonds have thrown off tax-free funds of better than 5%. With the money that comes in from the bonds, I have bought mostly utility stocks, preferred stocks and gold stocks. In other words, in the face of what I believe lies ahead, I have NOT opted for capital gains (I am not sure there will be any) but for INCOME. With income I can continue compounding, which is as sure a process as any in investing. It's been said that bonds are "guaranteed certificates of confiscation," meaning, of course, that the Federal Reserve will make sure that a dollar today will be worth a lot less ten years from today.

The certainty of inflation is now fixed in the minds of almost all Americans. After all, since World War II that's all we've known. But it is conceivable that a period of deflation lies ahead – at least a deflation in prices as opposed to inflation in the money supply (the latter seems to never end).

LATE NOTES: Faye and I went to the San Diego Sears store over the weekend. And the truth – I was amazed. The store had been completely done over, it was very attractive, loads of merchandise, prices were right. I was really surprised at what a good job Sears has done. We ended up buying a washer and dryer on sale, and I bought some T-shirts and sweatshirts, and a fannie pack.

It's been said that Sears has created more millionaires than any other company (employees accumulating stock). Sears stock was $10 back in 1990 – it rallied to $65 in 1997, fell to $26 in 2000, and last week hit a new 52-week high of $54. It looks like Sears is on the way up– my only objection, the small 92-cent dividend.

How good is business? I don't know. But I remain skeptical about all the good news. When I bought the washer and dryer from Sears, I asked about delivery, thinking a week or two (we bought the machines on a Saturday). They said they could "deliver the machines next day, Sunday." Next day delivery? How good can business be?

The stock market is as mixed as it can be. Everybody's excited about the rise in the mid-caps and small-caps even while the big stocks get whacked. The S&P mid-cap index is up 6.6% for the year while the S&P small-cap index is up 9.17%. Meanwhile, the broad S&P Composite is down 5.3% for the year.

Making real money in the stock market entails getting in on a primary trend and riding it to conclusion. When the big stocks, the "backbone of the economy" such as GE, IBM and AOL are struggling, I don't think you're going to make big money in secondary groups. Sure, you may pick up 10% or 15% before taxes, but is it worth the risk? Not to my mind, and not with my money.

Next mailing: May 8, 2002